

PERFORMANCE AUDIT  
OF THE  
DETROIT COLLEGE OF LAW -  
MICHIGAN STATE UNIVERSITY LAW ALLIANCE

October 1999

Ms. Dorothy V. Gonzales, Chairperson  
Michigan State University Board of Trustees  
and  
Dr. M. Peter McPherson, President  
Michigan State University  
East Lansing, Michigan

Dear Ms. Gonzales and Dr. McPherson:

This is our report on the performance audit of the Detroit College of Law (DCL) - Michigan State University (MSU) Law Alliance.

This report is issued pursuant to the annual appropriations act, which states that it is the intent of the Legislature that no funds, other than tuition and other revenues from law school students or private funds explicitly directed to the DCL-MSU Law Alliance, shall be used either directly or indirectly to support the joint law school. The Auditor General or a certified public accountant appointed by the Auditor General shall audit the financial and accounting systems of the DCL-MSU Law Alliance to determine compliance with legislative intent and report its findings to the Department of Management and Budget, House and Senate Fiscal Agencies, and members of the House and Senate Appropriations Subcommittees on Higher Education.

This report contains our introduction, audit objective, scope and methodology, description of DCL-MSU Law Alliance, discussion of cost allocation, description of the MSU costing structure, conclusions and agency responses, and a glossary of acronyms and terms.

If you have any questions, please call me or Michael J. Mayhew, C.P.A., Director of Audit Operations.

Sincerely,

Thomas H. McTavish, C.P.A.  
Auditor General

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# **DETROIT COLLEGE OF LAW - MICHIGAN STATE UNIVERSITY LAW ALLIANCE**

## **INTRODUCTION**

This report, issued in October 1999, contains the results of our performance audit\* of the Detroit College of Law (DCL) - Michigan State University (MSU) Law Alliance. This audit is mandated by the annual appropriations act, which states that it is the intent of the Legislature that no funds, other than tuition and other revenues from law school students or private funds explicitly directed to the DCL-MSU Law Alliance, shall be used either directly or indirectly to support the joint law school. The Auditor General or a certified public accountant appointed by the Auditor General shall audit the financial and accounting systems of the DCL-MSU Law Alliance to determine compliance with legislative intent and report its findings to the Department of Management and Budget, House and Senate Fiscal Agencies, and members of the House and Senate Appropriations Subcommittees on Higher Education.

## **AUDIT OBJECTIVE**

The objective of our performance audit of the DCL-MSU Law Alliance was to assess MSU's implementation of cost allocation and recovery methodologies in relation to DCL at MSU.

## **SCOPE AND METHODOLOGY**

Our audit scope was to examine the program and other records for the Detroit College of Law - Michigan State University Law Alliance. Our audit was conducted in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States and, accordingly, included such tests of the records and such other auditing procedures as we considered necessary in the circumstances.

\* See glossary at end of report for definition.

Our audit procedures were conducted during December 1998 through April 1999 and included examination of selected MSU records and activities for the period October 1, 1995 through April 30, 1999. We interviewed MSU and DCL personnel; reviewed applicable statutes, policies, and procedures; and analyzed and tested the application of established cost allocation and recovery processes. We assessed whether specific fees and related charges were reasonable and complete and included both direct and indirect costs of operating DCL at MSU.

## **DESCRIPTION OF DCL-MSU LAW ALLIANCE**

Founded in 1855, MSU is a Michigan public land grant institution of higher education. MSU, located in East Lansing, has authority to grant baccalaureate and graduate degrees. Founded in 1891 in the City of Detroit, DCL is the nation's oldest independent, continuously operating school of law. More than 7,000 attorneys, judges, public officials, and business executives are graduates of this private college.

In 1995, DCL began an affiliation with MSU with the intent of enhancing legal education and service to the community. Under the terms of the affiliation, DCL retains its independent status and no State money is to be used to support its activities.

MSU issued bonds for the construction of a new \$28 million DCL law school building on the MSU campus. The building includes a law library, classrooms, offices, and study areas utilized by DCL as well as the MSU Business Library. DCL began some classes on MSU's campus in rented space in fall 1996 and then moved its entire operation into the new law school building in fall 1997.

DCL is accredited by the American Bar Association and is a member of the Association of American Law Schools. In fall 1997, there were 513 students in the full-time program and 206 enrolled in the evening programs. DCL and MSU collaborate to offer joint degrees, enrich law-related research and outreach efforts, and provide professional development opportunities for the faculties of both institutions.

During fiscal year 1997-98, DCL paid approximately \$1.7 million to MSU for building rent; occupancy costs, such as custodial services, maintenance and repair, trash storage and removal, insurance, and utilities; MSU services rendered with a user fee or

charge, such as motor pool, general stores, and printing; and other out-of-pocket costs for services provided to DCL.

## **DISCUSSION OF COST ALLOCATION**

The total cost of a program has two components, direct costs and indirect costs. Direct costs are those costs that can be specifically identified with a particular activity or program.

Indirect costs are costs incurred for a common or joint purpose. These costs benefit more than one activity or program and cannot be readily identified with a particular activity or program. Indirect costs include the cost of central support services (such as accounting, purchasing, budgeting, payroll, and information systems) that are provided to operating units.

A cost allocation plan is the mechanism by which an entity identifies, summarizes, and allocates indirect costs in a logical and systematic manner. Cost allocation plans should be designed to allocate costs in an equitable and administratively efficient manner. The cost allocation plan effort should not exceed the cost benefit of making the cost allocation.

Governmental units frequently provide certain services (such as accounting, purchasing, computer centers, and motor pools) to operating units on a centralized basis. In order to properly match cost with the benefiting activity, there needs to be a process whereby these central service costs can be identified with and assigned to benefited activities on an equitable basis. Some services can be specifically identified with a specific activity and billed to benefited units and programs on a fee-for-service or similar basis. Typical examples of billed central services include computer services, transportation services, insurance, and fringe benefits. Other central services also benefit operating units but are not billed to the units on a fee-for-service or similar basis. These costs are allocated to benefited units on some reasonable basis. Examples of such services might include general accounting, personnel administration, and purchasing.

MSU, as a whole, does not systematically allocate indirect costs to its units and programs, but it does have internal service operations that provide services on a fee-for-service basis. Under the affiliation with DCL, MSU developed a four-tier costing

structure that outlines methods to be used to allocate costs to DCL. This structure was shared with the chairpersons of the House and Senate Appropriations Subcommittees on Higher Education in correspondence dated October 1, 1996. MSU informed us that it received verbal, positive confirmation from the chairpersons; however, it did not receive a written response to this letter. MSU implemented this four-tier costing structure in fiscal year 1996-97.

## **DESCRIPTION OF THE MSU COSTING STRUCTURE**

MSU's four-tier costing structure had the following components:

1. Debt Service - MSU charges DCL rent equal to DCL's allocated share of the building costs. Because MSU also occupies space in the same building, an allocation of costs was agreed to at the time that the DCL lease was executed. This allocation generally assigns all building costs, except those directly assignable to space occupied by MSU, to DCL. MSU utilized an incremental cost approach in that the base costs were applied to DCL and the added incremental costs were applied to the MSU Business Library. As a result of this approach, MSU is responsible for 18% of the building costs while it physically occupies about 26% of the building's assignable space. Given the approximate \$28 million construction budget, MSU paid \$2.5 million less in construction costs for its Business Library located in the DCL facility.
2. Occupancy Costs - DCL is obligated by its lease to pay the cost of MSU-provided custodial services, maintenance and repair, trash storage and removal, insurance, and utilities. The lease agreement specifies the methods to be used to calculate these charges.
3. Fee for Service - MSU provides services for a fee to DCL that it also provides to MSU departments and colleges for a service or user fee. DCL is assessed the same fee that MSU units pay. These services include the MSU motor pool, general stores, MSU printing, etc.
4. Services Without Charge - MSU provides services to DCL for which MSU does not charge. These services are also provided to MSU organizational units without



charge. DCL will be assessed for any additional out-of-pocket costs that are incurred as a result of DCL's use of such services. For example, DCL is not charged for police and fire protection, use of MSU's central data systems for student information and development, and campus mail delivery.

## **CONCLUSIONS AND AGENCY RESPONSES**

**Conclusion:** We concluded that MSU generally followed the costing structure outlined in its October 1, 1996 letter to the chairpersons of the House and Senate Appropriations Subcommittees on Higher Education. MSU is charging DCL an allocated share of the building costs; an allocated portion of occupancy costs, including custodial services, maintenance and repair, trash storage and removal, insurance, and utilities; and the same fees as those charged to MSU operating units for services rendered. However, in some instances, the appropriate amount was not charged or the amount charged was less than the full cost of the service rendered:

- a. During fiscal year 1998-99, DCL was not charged for MSU university relations personnel located at the law school building and performing services for DCL. During our audit fieldwork, MSU billed DCL approximately \$30,200 for direct salary costs. However, MSU did not bill DCL approximately \$8,900 for the related fringe benefits.

Also, MSU did not charge DCL for one half of an MSU full-time equated position utilized for university relations activities in fiscal year 1997-98. The cost of the salary and fringe benefits for this position amounted to approximately \$23,000.

**Agency Response:** MSU concurs and has charged DCL for both items.

- b. During fiscal years 1997-98 and 1998-99, the amount charged for financial aid services did not cover the full cost of the MSU personnel performing the services. Based on a comparison of DCL and MSU financial aid student head counts, MSU charged DCL approximately \$81,000 (\$4,500 per month) for financial aid services. However, the full cost, salaries, and fringe benefits of providing the services amounted to approximately \$127,800. Thus, approximately \$46,800 in actual costs was not charged.

**Agency Response:** MSU believes that DCL has been charged correctly for the financial aid services provided. MSU's agreement with DCL is to provide full financial aid services to DCL's students, not to provide specific staff members on a permanent basis. If DCL were to have an extremely busy period, for example, MSU would send additional staff to assist. By the same token, during slower periods, staff assigned to DCL may be asked to assist with projects in the other MSU aid offices. The fluidity of this arrangement serves both institutions well. MSU will continue to monitor utilization of the DCL financial aid satellite office traffic to support MSU's allocation methodology.

**Conclusion:** As outlined in its October 1, 1996 letter to the chairpersons of the House and Senate Appropriations Subcommittees on Higher Education, the costing structure implemented by MSU was designed to recover the MSU costs incurred by DCL in an administratively efficient and cost-effective manner. However, we concluded that MSU's costing structure did not fully meet the requirements of the appropriations act. In some instances, the structure used by MSU resulted in less than full cost recovery:

- (a) MSU did not charge DCL for grounds maintenance services, such as lawn and sidewalk maintenance, during fiscal years 1997-98 and 1998-99. The cost of the services amounted to approximately \$8,900.
- (b) MSU did not charge DCL for the cost of tuition collection, the use of MSU's central data systems, and mail delivery.
- (c) MSU physical plant overhead allocations did not include all costs of the operation of the physical plant.
- (d) MSU did not charge DCL for an undetermined amount of executive and general administrative costs related to DCL.

**Agency Response:** MSU anticipated many of the indirect cost allocations noted in the list above. As noted, it is current MSU practice not to charge for indirect costs because of the cost versus benefit associated with tracking and charging for indirect costs. This was the basis for developing the "Costing Practices" outlined in MSU's October 1, 1996 letter to the chairpersons of the House and Senate Appropriations Subcommittees on Higher Education.

It should be noted that MSU continues to review the cost versus benefit of systematically allocating indirect costs to all MSU units and programs. Any new indirect cost allocation methodology adopted will be applied consistently across MSU and to DCL.

Finally, MSU believes that it is important to acknowledge that DCL contributes academically and financially to MSU's educational mission through DCL's presence on campus and collaborative joint-degree programs. This presence facilitates academic opportunities and augments MSU tuition and fee revenues.

## Glossary of Acronyms and Terms

DCL	Detroit College of Law.
MSU	Michigan State University.
performance audit	An economy and efficiency audit or a program audit that is designed to provide an independent assessment of the performance of a governmental entity, program activity, or function to improve public accountability and to facilitate decision making by parties responsible for overseeing or initiating corrective action.